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C O N F I D E N T I A L SECTION 01 OF 02 CARACAS 000549

SIPDIS

DEPARTMENT FOR WHA/AND, EB  
NSC FOR CHRIS BARTON  
TREASURY FOR OASIA - GIANLUCA SIGNORELLI  
USCINCSO FOR POLAD

E.O. 12958: DECL: 02/13/2009

TAGS: [ECON](#) [EFIN](#) [PGOV](#) [VE](#)

SUBJECT: AFTERMATH OF DEVALUATION: INFLATION AND PRIVATE  
ECONOMIC ASSESSMENTS

REF: (A) CARACAS 429 (B) CARACAS 103

CLASSIFIED BY: AMBASSADOR CHARLES S. SHAPIRO FOR REASON 1.4 (B) AND (D)

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SUMMARY  
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1. (C) THE GOV FOLLOWED ITS FEBRUARY 9 DEVALUATION (REF A) WITH PRICE INCREASES ON SOME IMPORTANT PRICE-CONTROLLED STAPLES THE NEXT DAY. THE CHIEF ECONOMISTS OF VENEZUELA'S TWO LARGEST BANKS SAW THE DEVALUATION DIFFERENTLY IN CONVERSATIONS WITH ECONOFF. LUIS ZAMBRANO OF BANCO MERCANTIL SAID THE DEVALUATION SURPRISED HIM BECAUSE OF ITS EXPECTED NEGATIVE POLITICAL IMPACT FOR THE CHAVEZ GOVERNMENT. GIOVANNI DI PLACIDO OF BANCO PROVINCIAL BELIEVED THE TIMING OF THE DEVALUATION WAS INTENDED TO LOWER THE GOV'S COSTS ON EXPECTED BOND SWAPS. WHILE THE DEVALUATION'S IMPACT ON THE MAGNITUDE OF INFLATION IS DEBATABLE, THE EFFECTS OF CHRONIC HIGH INFLATION ON THE VENEZUELAN ECONOMY ARE SURE TO BE FELT.  
END SUMMARY.

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IMMEDIATE PRICE HIKES  
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2. (U) THE INFLATIONARY PASS-THROUGH FROM THE GOV'S FEBRUARY 9 DEVALUATION OF THE BOLIVAR WAS RAPID. ON FEBRUARY 10, THE MINISTRY OF PRODUCTION AND COMMERCE RAISED THE CEILINGS ON A RANGE OF PRICE-CONTROLLED STAPLES INCLUDING CORN FLOUR, PASTEURIZED WHITE CHEESE, COFFEE AND CORN AND SUNFLOWER OILS. THE PRICE HIKES RANGED FROM 10 PERCENT ON CORN FLOUR TO 30 PERCENT ON COFFEE. THE MINISTRY COMPLETELY REMOVED PRICE CONTROLS ON PASTEURIZED MILK. THE INCREASES CAME AFTER PUBLIC PRONOUNCEMENTS FROM MINISTER OF FINANCE TOBIAS NOBREGA DISCOUNTING IMMEDIATE INFLATIONARY EFFECTS FROM THE DEVALUATION.

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SURPRISED? YES, AND...  
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3. (SBU) LUIS ZAMBRANO, CHIEF ECONOMIST OF BANCO MERCANTIL, VENEZUELA'S LARGEST BANK, TOLD ECONOFF FEBRUARY 11 THE TIMING OF THE DEVALUATION WAS A SURPRISE. HE SAID BANCO MERCANTIL HAD EXPECTED A DEVALUATION IN 2004, BUT NOT UNTIL A RESOLUTION OF THE CURRENT POLITICAL CRISIS. ZAMBRANO PRESENTED THE BANK'S THREE NEW ECONOMIC SCENARIOS FOR THE YEAR BASED ON CONTINUATION OF THE CURRENT ADMINISTRATION OR POLITICALLY STRONGER OR WEAKER SUCCESSOR GOVERNMENTS TO THE CHAVEZ REGIME. UNDER ALL THREE SCENARIOS, HE EXPECTED INFLATION TO BE MUCH HIGHER THAN THE GOV PROJECTED 25 PERCENT FOR THE YEAR. THE ESTIMATES RANGED FROM 35 PERCENT UNDER A WEAK SUCCESSOR GOVERNMENT TO JUST OVER 40 PERCENT SHOULD CHAVEZ CONTINUE IN POWER. DESPITE HIGHER INFLATION, ZAMBRANO FORESAW POSITIVE ECONOMIC GROWTH FOR 2004 RANGING BETWEEN 7.6 PERCENT UNDER A CONTINUED CHAVEZ REGIME AND 9.2 PERCENT UNDER A WEAKER TRANSITION GOVERNMENT. BANCO MERCANTIL PROJECTED BETWEEN USD 3 AND 4 BILLION IN DEBT PLACEMENTS THIS YEAR.

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NO  
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4. (SBU) FROM BANCO MERCANTIL'S CHIEF RIVAL, BANCO PROVINCIAL, THE VIEW WAS SOMEWHAT DIFFERENT. BANCO PROVINCIAL CHIEF ECONOMIST GIOVANNI DI PLACIDO TOLD ECONOFF FEBRUARY 12 THAT THE DEVALUATION WAS NOT A SURPRISE TO HIM PRECISELY BECAUSE OF EXPECTED DEBT ISSUANCES. HE SAID GOV REFINANCING OF INTERNAL DEBT WITH EXTERNAL DOLLAR-BOND ISSUES WAS IMMINENT AND THE DEVALUATION WAS SIMPLY A WAY OF LOWERING THE UP-FRONT COSTS OF THOSE EXERCISES. UNLIKE ZAMBRANO, DI PLACIDO STRESSED THE IMPORTANCE OF CHAVEZ'S RECENT BOUNCE IN PUBLIC OPINION POLLS AS PROVIDING A POLITICAL MARGIN FOR ERROR THAT WOULD CUSHION ANY NEGATIVE FEEDBACK FROM THE DEVALUATION AND THE ENSUING UP-TICK IN INFLATION. DI PLACIDO ALSO WAS MORE CONSERVATIVE IN HIS ASSESSMENT OF THE INFLATIONARY IMPACT OF THE DEVALUATION WITH A PROJECTION OF ANOTHER 4.5 TO 5 PERCENT ON TOP OF THE EXPECTED GOV RATE OF 25 PERCENT. HIS PROJECTION FOR ECONOMIC GROWTH FOR THE YEAR

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PLACIDO'S CONVICTION THAT THE INFLATIONARY EFFECT OF DEVALUATION WILL BE RELATIVELY MILD, THE FISCAL POLICIES OF THE GOV LIKELY WILL FUEL HIGHER INFLATION THAN LAST YEAR'S 27.1 PERCENT (REF B). THAT FIGURE INCLUDED A HOST OF PRICE-CONTROLLED STAPLES THAT WILL HAVE TO BE ADJUSTED TO THE BOLIVAR'S NEW VALUE. HOWEVER, THE GOV HAS BEEN REMARKABLY SUCCESSFUL IN ITS BOND OPERATIONS OVER THE PAST YEAR AND THE HIGH YIELD BONDS ARE ATTRACTIVE VEHICLES FOR INVESTORS. THE NET RESULT FROM FUTURE DOLLAR-CONVERTIBLE BOND ISSUES WILL BE SOME TEMPORARY PULL BACK ON THE UNOFFICIAL EXCHANGE RATE, WHICH HAS AT TIMES TOPPED TWICE THE OFFICIAL RATE, AND A SOFTENING OF INFLATION FROM THAT QUARTER. THE HIGH-SPENDING WAYS OF THE CHAVEZ GOVERNMENT ALSO FIGURE IN THE MIX, SO THAT INFLATION WILL PROBABLY NECESSITATE ANOTHER DEVALUATION BEFORE YEAR'S END.  
SHAPIRO

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